UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

LEADER SIMULATION, INC.,	)	
	)	
Plaintiff	)	
	)	
v.	)	***Civil No. 91-409-P-H***
	)	
KERLIN PEI, MAINE YANKEE ATOMIC POWER COMPANY and H. M. SWARTZ,	)	
	)	
Defendants	)	

MEMORANDUM DECISION AND ORDER ON RECONSIDERATION OF DENIALS OF PLAINTIFF'S MOTIONS TO SUBSTITUTE PARTIES AND AMEND COMPLAINT

This is an action by a Maryland-based corporation, Leader Simulation, Inc. (``LSI" or ``corporation"), against Maine defendants Kerlin Pei, who holds 50 percent of the common stock of LSI, Maine Yankee Atomic Power Co. and H. M. Swartz, a managerial employee of Maine Yankee, for tortious interference with economic relationship, tortious interference with prospective advantage, breach of contract, breach of implied covenant of good faith and fair dealing, slander per se and breach of fiduciary duties. Patrick Lee, a Maryland citizen holding the remaining 50 percent of the stock in LSI, seeks to substitute himself for the corporation as the plaintiff for the purpose of continuing this suit as a shareholder derivative action and to amend the complaint accordingly. The defendants contend that Lee is barred from bringing this action because he is an inadequate shareholder representative who engaged in wrongful conduct relating to LSI and that, in any event, his proposed amended complaint aligns the parties so as to deprive the court of diversity jurisdiction.

LSI is in receivership pursuant to an order of the Circuit Court for Montgomery County, Maryland. Affidavit of Michael J. McAuliffe attached as Exh. A to Plaintiff's Memorandum of Law in Response to Defendant Kerlin Pei's Opposition to Plaintiff's Motion to Amend the Complaint and Motion to Substitute Parties (Docket Item 14) (``McAuliffe Affidavit I") && 2-3; *see* Order in *Pei v. Lee*, No. CV-42428 (Md. Cir. Ct., Mont. Cty., Dec. 20, 1991), accompanying *id.* The receiver, charged with reporting to the Maryland court his judgment as to whether the action pending in this court should be continued or discontinued, advised counsel in early January of this year that he would recommend that the corporation not continue to prosecute the action, but that the shareholders be permitted to assert the corporate claims in a derivative capacity. Exh. B to Memorandum of Law of Defendant Kerlin Pei in Opposition to Plaintiff's Motion to Amend the Complaint and Motion to Substitute Parties (Docket Item 12); McAuliffe Affidavit I && 6-7. In an affidavit filed with this court on March 16, 1992, the receiver stated his intention to appear before the Maryland court on April 21, 1992 for the purpose, among other things, of securing an order referencing his decision and recommendation that this suit be authorized as a derivative action. McAuliffe Affidavit I & 9.

On April 22, 1992 I denied the motions to substitute parties and to amend in the absence of an order of the Maryland court authorizing the continuation of this matter as a derivative suit and the participation of the receiver. Alternatively, I ruled that amendment would be futile inasmuch as the court would be divested of its diversity-based jurisdiction upon joinder of the receiver as a party defendant. I then issued a ``show cause" order directing the plaintiff to indicate why this action should not be dismissed for lack of prosecution. Endorsement to Docket Item 8. In response, LSI filed a

``preliminary reply" (Docket Item 21) which I treat as a motion to reconsider my rulings and as an adequate rejoinder to the ``show cause" order.[1]

On May 6, 1992 the Maryland court authorized Lee to proceed with this suit as a derivative action and the receiver to ``participate, to the extent necessary, to preserve the assets of [LSI], by affiliating himself with the authorized cause[] of action as necessary to accommodate the procedural requirements of any court." Order in *Leader Simulation, Inc. v. Pei*, No. Misc. 8568 (Md. Cir. Ct., Mont. Cty., May 6, 1992), accompanying Plaintiff Leader Simulation, Inc.'s Preliminary Reply Pursuant to Local Rule 30(b) (Docket Item 21). There remains for consideration whether Lee satisfies the adequacy-of-representation requirement of Federal Rule of Civil Procedure 23.1 and whether, upon substitution of Lee as plaintiff and amendment joining LSI as an indispensable party, the court will retain diversity jurisdiction.

The defendants assert that Lee is an inadequate representative of the shareholders' interests because his interests conflict with those of Pei. Defendant Kerlin Pei's Memorandum Objecting to Plaintiff Leader Simulation, Inc.'s Preliminary Reply Pursuant to Local Rule 30(b) (Docket Item 24) (``Pei's Memorandum") at 3-5; Objection of Defendants Maine Yankee and Swartz to Plaintiff's Preliminary Reply Pursuant to Local Rule 30(b). Lee responds that Pei is not similarly situated and that therefore Lee is a class of one. Memorandum of Law in Support of Plaintiff's Reply to Defendant Kerlin Pei's Opposition to Plaintiff's Motion for Reconsideration (Docket Item 28) (``Plaintiff's Memorandum") at 4-11.

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[1] I remind the plaintiff's counsel that Local Rule 3(d)(1) requires all papers to be signed by local counsel. On several filings, not including the ``preliminary reply," it appears that Mr. Cary has signed for Mr. Cackett but not in his own right, as he must.

Rule 23.1 states that a derivative action may be prosecuted only where, in enforcing the rights of a corporation, the plaintiff fairly and adequately represents the interests of the shareholders who are similarly situated. Fed. R. Civ. P. 23.1. ``An adequate representative must have the capacity to vigorously and conscientiously prosecute a derivative suit and be free from economic interests that are antagonistic to the interests of the class." *Larson v. Dumke*, 900 F.2d 1363, 1367 (9th Cir.), *cert. denied*, 111 S. Ct. 580 (1990). It is the defendants' burden to show that the representation will be inadequate. *Lewis v. Curtis*, 671 F.2d 779, 788 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982). An evaluation of a plaintiff's adequacy involves a consideration of several factors, including the level of support that other shareholders show for the derivative action. *Larson*, 900 F.2d at 1367. However, in some circumstances a single shareholder may institute a derivative suit, such as when he constitutes the only member of his class.[2] *Id.* at 1368-69. Whether a plaintiff has satisfied the adequate-representation requirement is a matter committed to the court's sound discretion. *Jordon v. Bowman Apple Prods. Co.*, 728 F. Supp. 409, 412 (W.D. Va. 1990).

Lee and Pei are the only shareholders of LSI. As a defendant with potential liability, Pei is clearly antagonistic to the suit, and because he has an economic interest in defeating it he cannot be deemed similarly situated to Lee who stands only to gain from a successful prosecution of the corporation's rights. *See, e.g.*, *Larson*, 900 F.2d at 1368; *Jordon*, 728 F. Supp. at 412-13. To hold

[2] The defendants argue that a single shareholder may never bring a derivative suit. Although the cases are not uniform on this point, most reject this view. *Larson*, 900 F.2d at 1368; *Jordon v. Bowman Apple Prods. Co.*, 728 F. Supp. 409, 412 (W.D. Va. 1990). Indeed, I find only one case which supports the proposition. In *Kuzmickey v. Dunmore Corp.*, 420 F. Supp. 226 (E.D. Pa. 1976), which unlike the instant case involved a corporation with several shareholders, the court concluded that the relevant language of Rule 23.1 can only be read to mean that ``a derivative action may not be maintained unless the plaintiff represents `interests of shareholders' other than herself." *Id.* at 231. This reading of the rule is unpersuasive. It is not compelled by the plain language of the rule and would preclude all derivative suits by single shareholders of closely-held corporations, however worthy, seeking to enforce corporate rights against the only other shareholder for wrongful conduct.

otherwise would be to impose an irreconcilable conflict on a plaintiff, that is, to represent the interests of his opponent. *See* 7C C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* ' 1833 at 138 (1986) (If antagonism by majority shareholders was ``treated as demonstrating inadequacy of representation, it could result in a dismissal of virtually all derivative suits."). Although in theory Pei would indirectly benefit as a shareholder from any damages awarded to the corporation, only a manifest disregard for the facts would permit the court to accept that as a basis for finding him similarly situated to Lee. In sum, I conclude that as a class of one Lee's position as a plaintiff does not conflict with the adequate-representation requirement of Rule 23.1.

The defendants also assert that Lee's suit should be equitably barred because he has engaged in wrongful conduct relative to the corporation and has thus disqualified himself from assuming the fiduciary role of a shareholder prosecuting a derivative suit. Pei's Memorandum at 5-6. Specifically, the defendants assert that Lee: (1) denied Pei's part ownership interest in the corporation, (2) expended corporate funds in direct contravention of a court order, (3) made deliberate misrepresentations to Pei, (4) realized economic gain from business ventures in competition with LSI and (5) caused LSI to be placed into receivership by dissipating corporate funds. *Id.* In support of their argument, the defendants assert that in an unrelated action a Maryland court found that Lee committed some of these misdeeds. *Id.*; *see Lee v. Pei*, No. 421 (Md. Ct. Spec. App., Dec. 26, 1990), Exh. III to *id.* Lee disputes committing the alleged misconduct. Plaintiff's Memorandum at 11-13.

A derivative suit brought by a plaintiff who participated in or consented to the wrongful conduct alleged in the complaint may be barred by the equitable doctrine of unclean hands.[3] *Johnson*

[3] As asserted by the defendants, a derivative-suit shareholder-plaintiff does assume a fiduciary role as a proxy for the class he represents. *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 549 (1949). However, he does not assume such a role on behalf of the corporation itself. ``[T]he motives of the minority party are immaterial as long as the action is, in fact, instituted by the minority stockholder and

v. King-Richardson Co., 36 F.2d 675, 678 (1st Cir. 1930). However, the doctrine is inapplicable where the plaintiff's wrongful conduct does not involve the specific allegations in the complaint. *Wolf v. Frank*, 477 F.2d 467, 476 (5th Cir. 1973) (``Plaintiffs' actions, alleged to be illegal, were in no way involved with the transactions . . . [and w]hether plaintiffs were or were not knights in shining armor is irrelevant under Rule 23.1 . . . so long as they fairly and adequately represented the shareholders . . . "), *cert. denied*, 414 U.S. 975 (1973). The cases cited by the defendants in support of their argument, *Recchion ex rel. Westinghouse Elec. Corp. v. Kirby*, 637 F. Supp. 1309 (W.D. Pa. 1986), and *Roussel v. Tidelands Capital Corp.*, 438 F. Supp. 684 (N.D. Ala. 1977), do not suggest otherwise. The *Kirby* court simply held that the plaintiff was barred from representing the corporation because he had participated in the wrongful conduct alleged in the complaint. *Kirby*, 637 F. Supp. at 1316. In *Roussel*, the court relied on the plaintiff's wrongful conduct as evidence that he was an inadequate representative -- which I have already concluded is not relevant here because Lee constitutes a class of one. *Roussel*, 438 F. Supp. at 688-89. Therefore, while there may be evidence that Lee has engaged in the wrongful conduct alleged by the defendants, it is not a basis for barring his prosecution of this lawsuit as a derivative action.

The defendants contend that, if this suit is allowed to proceed as a derivative action, the corporation must be aligned as a defendant with the consequence that the court will be divested of its diversity-based jurisdiction. Pei's Memorandum at 7-9. Lee contends that there is no antagonism between himself and the corporation and that therefore LSI may properly be aligned as a plaintiff in order to preserve diversity jurisdiction. Memorandum of Law in Support of Plaintiff's Reply to

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not controlled by other parties." *Mardel Securities, Inc. v. Alexandria Gazette Corp.*, 320 F.2d 890, 897 (4th Cir. 1963); *see also Johnson v. King-Richardson*, 36 F.2d 675, 677 (1st Cir. 1930).

Defendants Maine Yankee's and H. M. Swartz's Opposition to Plaintiff's Motion for Reconsideration (Docket Item 27) at 3-8.

A longstanding rule of diversity jurisdiction is that parties on opposite sides of the litigation cannot be citizens of the same state. *Smith v. Sperling*, 354 U.S. 91, 93 (1957); 28 U.S.C. ' 1332(a)(1). Both Lee, the putative plaintiff, and LSI, the putative defendant, are Maryland ``citizens." Thus, the defendants are correct in asserting that the proposed amended complaint would deprive the court of diversity jurisdiction. However, this does not end the matter. It is the court, not the parties, that determines proper alignment, and this is done according to the real interests of the parties, regardless of the caption on the complaint. *Liddy v. Urbanek*, 707 F.2d 1222, 1224 (11th Cir. 1983).

Typically, in a derivative suit the plaintiff aligns the corporation as a defendant in the first instance to insure its presence as an indispensable party. *Id.* In theory, the corporation should then be realigned as a plaintiff because it will receive any damages resulting from successful prosecution of the suit, making it the real party-in-interest. *Id.* However, where the corporate management is ``antagonistic" to the suit there is a collision of interests and the corporation must be aligned as a defendant. *Smith*, 354 U.S. at 95-98. ``This is a practical not a mechanical determination and is resolved by the pleadings and the nature of the dispute." *Id.* at 97. Although antagonism may be evident whenever management refuses to take action against the conduct alleged in the complaint, a corporation's asserted neutrality or failure to actively oppose the suit will result in a finding that there is no antagonism. *Liddy*, 707 F.2d at 1224-25; *Lewis v. Odell*, 503 F.2d 445, 447 (2d Cir. 1974). The proper course under such circumstances is to align the corporation as a plaintiff. *Id.*

The corporation is currently controlled by the receiver who operates it under the aegis of a Maryland court. Although the receiver stated that LSI will not pay to prosecute the suit, he also

remarked that the corporation does not oppose the suit and would not contest alignment as a plaintiff.[4] McAuliffe Affidavit I & 5; Second Affidavit of Michael J. McAuliffe (Docket Item 20) && 7-8; Affidavit of Michael J. McAuliffe, Court-Appointed Receiver of Leader Simulation, Inc. (Docket Item 23) & 4. As is required before the plaintiff can proceed, the Maryland court has authorized the suit as well as LSI's proposed involvement in it. This evidence dispels any presumption that the corporation's failure to enforce its rights amounts to antagonism toward the derivative suit.[5] Finding no evidence that the interests of Lee and LSI collide, I conclude that the corporation should be aligned as a plaintiff. Diversity jurisdiction is, therefore, preserved.

Upon reconsideration and for the foregoing reasons, I ***VACATE*** my previous orders denying the plaintiff's motions to substitute parties and to amend the complaint, ***GRANT*** said motions and otherwise ***ORDER*** that LSI be aligned as a party plaintiff.

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[4] The defendants argue that the court may not rely on the receiver's affidavit setting forth LSI's position because it was not filed by the deadline imposed by the court. An unsigned copy of the affidavit was timely filed and the signed original was filed soon thereafter.

[5] The defendants assert that Lee has a history of injuring the corporation which makes alignment of LSI with his cause inappropriate. However, the question for the court is whether the corporation opposes the suit -- not whether it has reason to do so.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. ' 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated at Portland, Maine this 29th day of June, 1992.

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David M. Cohen
United States Magistrate Judge